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The Importance of Microfinance for Development of MSMEs in ASEAN: Evidence from Indonesia

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Abstract

Despite studies on microfinance (MF) or development of microfinance institutions (MFIs) in Asia developing countries, including countries as member states of the Association of Southeast Asian Nation (ASEAN), are growing, not so much attention have been given to the role of MF in financing micro, small and medium enterprises (MSMEs). Based on a key literature study and analysis of secondary/national data, the main aim of this study is to fill this gap. It shows that in many ASEAN member states (AMS) MF has developed to some significant degree, although the rate of growth (e.g. number of MFIs, number of depositors and debtors, total loans allocated, etc.) as well as the market structure of MF vary across member states. From the Indonesian case this study comes with two most interesting facts. First, majority of MSMEs do not have access to credit from banks and/or other formal non-bank financial institutions. Second, MF services or MFIs are growing fast, and the most popular MF program so far is Kredit Usaha Rakyat (KUR), or people business credit (i.e. a credit scheme without collateral), introduced during the SBY period.

Keywords: MF, MFIs, Indonesia, MSMEs, KUR, ASEAN

Introduction

Microfinance (MF) is the provision of small-sized financial services to the poor or the low-income parts of the population and their business activities, mainly in micro, small and medium enterprises (MSMEs). Although there is no standardized number to define different "micro" products in quantification, in its broadest sense, it covers a whole range of low value financial products, including savings, credit, insurance, transfer and payments services (WSBI, 2008). In Asian developing countries, institutions providing MF services or microfinance institutions (MFIs) can be categorized as: (i) formal MFIs, as those subject not only to general laws and regulations, but also to banking regulation and supervision; (ii) semi-formal MFIs, those that are formal as registered entities subject to all relevant general laws, including commercial laws, but informal insofar as they are, with few exceptions, not under banking regulation and supervision, such as financial non-governmental organizations (NGOs), credit unions and cooperatives; and (iii) informal providers (generally not referred to as institutions), those to which neither special banking law nor general commercial law applies such as private lenders (www.cgap.org/p/site/c/template.rc/1.26.1308). Even, Lapeneu and Zeller (2001) ever

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conclude that the region is the most developed part of the world in terms of volume of MFI activities. Their conclusion is based on their analysis of over 1,500 institutions from 85 developing countries. Comparing MFIs in Asia with those in Africa and Latin America, they found that Asia accounted for the majority of MFIs, retained the highest volume of savings and credit, and served more members than any other continent.

In some ASEAN (Association of Southeast Asian Nations) member states (AMS) e.g. Indonesia, Thailand, Cambodia, Lao PDR, Viet Nam, the Philippines and Myanmar, MF has been playing an important role; it has been long focused on serving the poor households and MSMEs. In these countries, as in the developing world in general, MF is often seen as an effective instrument to help low-income households take advantage of economic opportunities and improve living standards, or to reduce poverty. In Indonesia, as MSMEs in general lack of access to credits, development of MFIs has been seriously supported by the government to provide loans to these enterprises, particularly microenterprises (MIEs). Within ASEAN, Lapeneu and Zeller (2001) found that the largest number of members served by MFIs and the largest loans distributed by and mobilization of savings through MFIs in terms of gross national product (GNP) were in Indonesia, Thailand and Viet Nam.

Despite studies on MF or development of MFIs in Asia developing countries including in AMS (except Singapore) are growing, not so much attention have been given to the role of MF in financing MSMEs. Most of available studies do not make a distinction between loans for households and those received by MSMEs. To fill this gap, the purpose of this study is to examine the importance of MF in financing MSMEs in Indonesia. Theoretically, the results in this study will be a starting point for more comparisons studies of the importance of MF in supporting MSMEs in the ASEAN region. It will also assist policy makers in the region in supporting capacity building of MFIs, which in turn it will help to increase the role of MFIs in financing MSMEs in the ASEAN region. This study only utilizes the available data on total credits received by MSMEs from commercial banks instead of the exact share of total allocated microcredit/MF that went to MSMEs.

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MSMs and MF in ASEAN in Brief

MSMEs

Historically, MSMEs have always been the main players in domestic economic activities in ASEAN. As can be seen in Table 1, in Indonesia, the largest economy in the region, the latest statistics indicate that MSMEs constituted almost 100% of total business establishments, and contributed about 58.17% of the country's gross domestic product (GDP) and 99% of total employment, mostly women and youth. The majority of MSMEs are from the category of microenterprises (MIEs), dominated by self-employment (or own account) enterprises without wage-paid workers. In Malaysia, the enterprises constituted 99.2% of total firms and 59% of total workforce, and the enterprises shared around 32% of Malaysian GDP. In the Philippines, MSMEs accounted for about 99.6% of total registered businesses, through which 63% of labor force in the country earned a living. Around 35.7% of total sales and value-add in manufacturing also came from these enterprises, and they contributed around 32% of the country's total aggregate output. In Thailand, the total number of enterprises at the end of 2010 was 2,924,912, of which 2,894,780 were micro and small enterprises (MSEs) and 18,387 MEs giving a number of 2,913,167 MSMEs in total – accounting for 99.6% of all enterprises. The GDP value of MSMEs was 3,746,967 million baht in 2010 or 37.1% of the country's GDP. As concerns employment, in 2010 the number of people employed by enterprises of all sizes totaled 13,496,173. Of this number, large enterprises (LEs) employed 2,988,581 people and MSMEs 10,507,507 people, or 77.86% of overall employment. In Vietnam, in 2002 there were 2,718,000 MSMEs from total business establishments of 2,720,000, and they had 6,483,000 workers, or about 77.3% of total employment in that year. The enterprises contributed to around 39% of the country's GDP. In Lao PDR, among the least-developed member states of ASEAN, private sector dominates the country's economy, namely around 99% of total existing enterprises and approximately 94% of total employment. There were 306 MSEs and 64 MEs, compared to only 20 LEs. In Cambodia, an estimated 40% to 50% of total employment can be attributed to these enterprises. The role of Cambodian MSMEs in the private sector and economic development has become more important after the government adopted its new economic system, from a planned economy to a market economy, in the early 1990s. In Brunei Darussalam, the richest member state, most recent information about MSMEs from the Department of Economic Planning and Development estimates these enterprises constitute around 98% of all business establishments, and contributed approximately 92% to total employment in the country. In Singapore, the smallest sized member state, these enterprises are estimated to account for more than 90% of all enterprises and their GDP contribution is estimated to be around 60%. Finally, in Myanmar, another member state with as yet a very low level of economic development, there is only official data about MSMEs' share in total employment, estimated at around 96%.

Table 1 MSMEs' Contributions to Total Enterprises, Employment and GDP in ASEAN by Member State, Most Recent Data (%)

	Indonesia	Malaysia	The Philippines	Thailand	Vietnam	Lao PDR	Cambodia	Brunei	Singapore	Myanmar
Number of unit	99.9	99.2	99.6	99.6	99.9	99.98	99.0	98.5	99.0	96.0
Employment	99.0	59.0	63.0	77.9	77.3	99.0	50.0	98.0	51.8	n.a
GDP	58.2	32.0	32.0	31.7	39.0	69.0	76.7	68.4	60.0	n.a

Note: n.a = data not available

Sources: data/information collected from Goh (2007); ADB (2009); UN-ESCAP (2009); Tambunan (2009a,b); Indonesian Ministry for Cooperative and SME (Menegkop & UKM: www.depkop.go.id); Indonesian National Agency of Statistics (BPS: www.bps.go.id); National SME Development Council (2011); Department of Trade and Industry Philippines (http://www.dti.gov.ph/dti/ index.php?p=321); OSMEP (2010); IFC (2010), ASMED Business Portal, Enterprise Development Agency, Ministry of Planning and Investment Viet Nam (http://www.business.gov.vn/asmed.aspx?id=3040); Souvannavong (2006), Meas (2004), Brudirect.com (http://www.bruneidirecthys.net/about_brunei/small_medium.html), Spring Singapore (http://www.spring.gov.sg/aboutus/pi/pages/performance-indicators.aspx), Harvie and Lee (2002), Ministry of Industry Myanmar (http://www.myanmarindustry2.com/index.php?option=com_content&view=article&id=70&lang=en), Walsh and Southiseng (2011), Tham (2009a,b), ASEAN (2011), Win (2012), and MPI (2011).

MF

In many AMS, microfinance has developed to some significant degree although the rates of growth (e.g. the number of MFIs, the number of depositors and debtors, total loans allocated, etc.) as well as the market structure of MF vary across member states, depending on many local factors. The most important ones among those factors are the stage of financial development (including the importance of informal financial institutions and the access of people to formal conventional financial institutions), the level of economic development (including level of industrialization), level of urbanization, level of per capita income, the balance between private and public involvement in the development process of MF or MFIs, and the incidence of poverty.

The considerable diversity between member states in the degree to which systems of MF have emerged and in the institutional forms developed or adopted to them is also strongly related to national policy environment, especially policy towards MF. In some member states, e.g. Indonesia and Thailand, development of MF is an integral part of development of their national financial sectors or system. In both countries, government financial institutions have primary responsibility for MF. In Indonesia and the Philippines, as they are still facing a serious problem of poverty, MF is also an important element of their poverty alleviation strategies and MSMEs development policies. The difference in policy environment towards MF has resulted in different levels of participation of NGOs in acting as MF service providers. In the Philippines, MF has followed a more conventional course, based primarily on the energies of a burgeoning NGO community. Especially the influence of Grameen Bank methods of MF service delivery has been very strong in that NGO community. Although the government has a regulatory environment favorable to the operation of small regulated banks suitable for MF, the role of NGOs has been encouraged to develop sustainable MF programs, and is beginning to promote the transformation of successful MF NGOs into regulated financial institutions. While Indonesia has adopted a model of MF service provision based very largely on the operations of regulated financial institutions, whereas NGOs are of relatively limited significance. However, as will be discussed later on, Indonesia also has some mass microcredit programs involving NGOs and other community organizations [especially in the late New Order (Soeharto) era] which were politically-driven and not at all concerned with sustainability (Conroy, 2003).

Unfortunately, recent literature on MF or development of MFIs so far is only available for certain member states. Therefore, this section on MF in ASEAN only deals with these member states only, beside Indonesia as the case study (to be discussed in the next section), namely Malaysia, Thailand and the Philippines. In Malaysia, for instance, as the country has considerably higher level of income per capita than either Indonesia or the Philippines, absolute poverty is regarded as a residual and diminishing problem which could be eliminated early in this current century. Hence, MF services for people without access to conventional financial institutions have been seen within the framework of a redistributive social policy involving substantial subsidies (Conroy, 2003). This country has a modern financial system with a diverse range of institutions, both private and public, including Islamic banks. Public institutions include development financing institutions, i.e. a development bank and an agriculture bank, as well as the Credit Guarantee Corporation (CGC) which provides guarantees on lending by other financial institutions to MSMEs. At the lower end CGC has a credit guarantee scheme for hawkers and petty traders, but loan sizes for this scheme suggest it is operating at a level somewhat above conventional MF. There are also urban as well as rural credit cooperatives. Essentially the only institutions engaging in MF are drawn from the NGO community, where there is one dominant MFI and a handful of minor operators (Conroy, 2003). The most dominant MFI in Malaysia until recently was *Amanah Ikhtiar Malaysia* (AIM), which was established in 1987. Up to 1998 it made some 103,000 loans and disbursed a total of RM 328 million (approximately US$86 million). Some 80% or more of all funds loaned were for economic purposes, the remainder for 'social' purposes such as healthcare and education (Sukor Kasim 2000).

In Thailand, as it is a relatively prosperous economy and has comparatively minor poverty problems (Thai poverty is concentrated only in certain regions), MF is much less popular than in Indonesia and the Philippines (Meyer and Nagarajan 2000). Thailand does not have specialized MF services. Probably another important reason is the large outreach achieved by the State agricultural bank, i.e. Bank for Agriculture and Agricultural Cooperative (BAAC), with having reduced the need for specialized MFIs. BAAC established in 1966 is the principal formal financial institution of relevance to low-income rural people in Thailand (Muraki, *at al*., 1998). Cash and in-kind transfer payments support the poor in affected regions, and the availability of government credit schemes may also explain the less popular microfinance in Thailand (Conroy 2003).

Nevertheless, as in other countries, there are various key players in MF in the country which can be categorized into formal and informal MFIs. From the formal category: commercial banks, and government-owned specialized financial institutions (i.e. Government Saving Bank (GSB), BAAC, SME Development Bank, and Government Housing Bank (GHB). In the semi-formal category: cooperatives and credit union; and village and Urban Community Fund. Whereas, in the informal sector are independent and self-help community saving groups (Boonlonlear, 2010).

In the Philippines, MF has followed a more conventional course, based primarily on the energies of a burgeoning NGO community. As non deposit-taking institutions, NGOs are not subject to any prudential regulation. MF NGOs, nonetheless, are required to register and submit annual financial reports to Securities and Exchange Commission (SEC). Besides MF NGOs, rural banks, thrift banks and credit unions or cooperatives banks are also engaged in MF operations under the supervision of the Central Bank of Philippines. Cooperatives with savings and credit services are also an important category of MFI in the country. In 2006, the policy action taken in the MF development program further required NGOs to disclose to SEC that they are engaged in the delivery of MF services (ADB, 2012).

Like in Indonesia, commercial banks in the Philippines have had limited engagement with MF; only government-owned financial institutions have had any substantial involvement. The Development Bank of the Philippines, the Land Bank and the People's Credit and Finance Corporation (PCFC) have provided wholesale loans to all the three categories of MFIs for on-lending to MF clients (Conroy 2003). Although, the country can be considered as the most important country within ASEAN with respect to the role of NGOs in providing MF services, the rural banks appear not only to deal with somewhat higher-income clients but also to make larger loans than the NGOs. However, the role of NGOs has been encouraged by the government to develop sustainable MF programs, and is beginning to promote the transformation of successful MF NGOs into regulated financial institutions. Differently than in Indonesia and Malaysia, the influence of Grameen Bank methods of MF service delivery has been very strong in the Philippines, especially in NGO community Many of the NGOs have adopted variants of the Grameen bank model. Most MF NGOs are financed by foreign donors, or by domestic philanthropists or foundations (Llanto, 2000, 2001; Conroy, 2003).

In Cambodia, MF has grown rapidly over the last ten years, expanding from just US$ 3 million of outstanding loans and 50,000 borrowers in 1995, to a remarkable US$ 732 million and 1,197,722 borrowers in 2012 (Liv, 2013). In the same year, a total of 54,653 poor families were supported by MFIs and 58,551 individuals were granted micro credits. Many MFIs also provided training courses, and according to the same information source in that year 28,789 attendances at training courses (http://www.entrepreneursdumonde.org/en/nos-actions/nos-partenaires locaux/chamroeun/?gclid=CPSBwJGNo78C FVU MjgodkQ0AZw). The country has successfully professionalized as one of the leading MF in ASEAN (Liv, 2013).

As of January 2013, there are 33 operating MFI. Among these, the most important ones are including AMRET MFI (AMRET), Angkor Mikroheranhvatho (Kampuchea) Co. Ltd (AMK), Angkor ACE Star Credits Limited (Angkor ACE), Cambodian Business Integrated in Rural Development Agency (CBIRD), Cambodia Rural Economic Development Initiatives for Transformation (CREDIT), Farmer Finance LTD (FarmerFinance), Farmer Union Development Fund (FUDF), Green Central MF (GREEN), PRIME MFI Ltd (Prime), SAMRITHISAK MF Limited (SAMRITHISAK), and Sonatra MFI (Sonatra) (http://mpsinfo.wordpress.com/2011/10/26/banks-and-mfis-in-cambodia/). There are claims, however, that MFIs in the country might be nearing saturation. Concerns have been raised that the possibility of over-indebtedness among borrowers could undermine the social mission and the sustained healthy development of MFIs (Liv, 2013).

In Lao PDR, MF was introduced in the form of rice and livestock banks in the late 1980s. The first formal regulation of credit cooperatives was issued by Bank of Lao PDR (BoL) in 1994. Two of the credit cooperatives from this era survive today (Mingboupha, 2010).Although still in its infancy, MF is gaining momentum. Starting from just three providers in early 2004, since then 13 new licensed MF providers have been created, totaling 16 formal MFIs as of 2010. BoL has licensed 5 MFIs and 11 savings and credit unions to take deposits. Up to recently, 5,000 semiformal village based and managed loan funds have been created. Of those semi-formal providers, so far eight (8) have registered with the BoL. The Prime Minister's Office (PMO) has explicitly mandated BoL to regulate and monitor activities of MF in the country (FDC, 2010).

Demand for MF services in the country is immense. Recent figures which are available show that rural households, which make up 80% of all households and 90% of poor households in Lao PDR, demanded for credit amounted to US$500 million. Whereas, MF providers serviced a combined total of a mere 6.5% of the population between 15 and 64 years old, and reached about 46% of all villages (FDC, 2010).

In Myanmar, MF is widely seen as a key development tool to promote financial inclusion and alleviate poverty. While cooperatives have existed in country since the early 20th century, MF was first introduced to Myanmar in 1997 by UNDP's Human Development Initiative. In November 2011, the government passed the new MF Law, paving the way for expansion of MF services by allowing local and foreign investors to establish wholly privately owned MFIs in country. There are six kinds of providers of MF services in Myanmar: 1) informal and semi-formal institutions; 2) banks; 3) cooperatives; 4) NGOs; 5) specialized agricultural development companies; and 6) government organizations. Based on the limited data available, Duflosm, *et al*. (2013) have estimated that current MF outreach is 2.8 million micro-clients, with a total loan portfolio of 236 billion kyats (US$283 million). Relative to the enormous demand, there are few institutions that provide MF services that have the potential to reach a large scale while providing their services in a financially sustainable and responsible way. State-owned banks, such as Myanmar Economic Bank (MEB) and Myanmar Agriculture Development Bank (MADB), have a large outreach. MADB provided deposit and credit to more than 1.4 million people in rural areas, but on a subsidized basis. Private banks are not involved in MF, partly for regulatory reasons and partly because of a lack of interest.

In Vietnam, MF has its roots in government social protection measures for the poor. Because the vast majority of the poor population lives in rural areas, MF has traditionally been interpreted as the market for financial services for rural households. Micro-credit in particular has been interpreted as the provision of subsidized credit facilities for the poor, and quantitative 'coverage targets' has been promoted in response to a perceived unmet demand for credit among the rural poor. Vietnam currently has 52 MFIs offering microloans and other services to the impoverished. Of the 52 MFIs, as of 2011, only one is officially licensed by the government. However, the Vietnamese MF market is characterized by the dominance in scale and depth by three formal providers: (i) the state-owned Viet Nam Bank for Agriculture and Rural Development (VBARD or Agribank), which is the largest bank in the country and by far the largest provider of the full range of financial services in rural Viet Nam; (ii) Viet Nam Bank for Social Policy (VBSP) which was reconstituted in 2002 from the Viet Nam Bank for the Poor, and has a nationwide network, and partly subsidized by local People's Committees; and (iii) 984 People's Credit Funds (BWTP, 2008).

Indonesian Case

Development of Credit for MSMEs

Total number of MSMEs in Indonesia is growing every year. In 2012, their share in total enterprises (including large enterprises/LEs) was around 99%. The majority of them are from the micro and small enterprises (MSE) category, which are scattered widely throughout rural areas. Most MSEs are undertaken or set up by poor households or individuals who could not find better job elsewhere, either as their primary or secondary (supplementary) source of income. The majority of MSMEs are engaged in agricultural activities. Within the MSMEs, MSEs are mostly agricultural-based compared to MEs. The second important sector for MSMEs is trade, hotel and restaurants.

Indonesian MSMEs also share the same feature as MSMEs in other AMS or in developing countries in general which is only a small percentage of the enterprises have ever obtained credits from banks or other non-bank formal financial institutions. For instance, the majority of MSEs in the manufacturing industry financed their operations 100% by themselves; although the ratio varies by group of industry. From those who financed their businesses also or fully from outside sources, only few borrowed money from banks (Table 2).

Table 2. Percentage of Total MSEs in Manufacturing Industry by Source of Capital and Group of Industry in Indonesia, 2010

Group of industry	Total unit	Source of capital (% of total unit)		
		100% own	Partly own	100% outside sources.
Food	929910	0.83	0.15	0.02
Beverages	30395	0.91	0.08	0.01
Processed tobacco	53169	0.57	0.41	0.02
Textile	234657	0.76	0.16	0.08
Garment	276548	0.74	0.22	0.04
Leather & its products, including footwear	32910	0.57	0.38	0.05
Wood & its products (not including furniture) & handicraft	639106	0.87	0.098	0.03
Paper & its products	7268	0.41	0.39	0.2
Publishing & Recording Media	24305	0.698	0.28	0.22
Reproduction	19168	0.75	0.19	0.06
Chemical & its products	5043	0.93	0.05	0.02
Pharmacy, chemical medical products & traditional medicine	13786	0.58	0.22	0.2
Rubber & plastic & their products	215558	0.72	0.25	0.03
Excavated non metal products	1553	0.57	0.42	0.01
Basic metal	61731	0.75	0.23	0.02
Metal products non-machinery and its tools	434	0.98	0.02	0
Computer, Electronic goods and optics	199	0.61	0.39	0
Electrical tools	1540	0.53	0.34	0.13
Machineries and their tools	3488	0.99	0.01	0.0014
Vehicles, Trailer and semi-trailer	4708	0.75	0.21	0.04

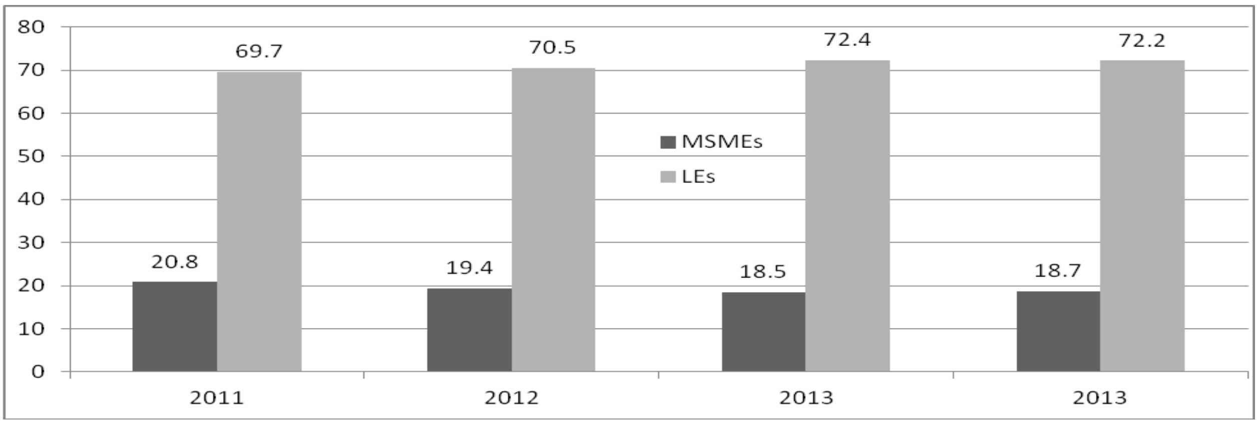
Other transportation tools	107166	0.73	0.24	0.03
Furniture	62898	0.75	0.2	0.05
Other manufactures	7184	0.86	0.139	0.01
Repairs services & machines and their tools installation				
	2732	0.795	0.1696	0.035
Total	724			

Source: BPS (2010)

This fact is consistent with findings from the Financial Service Survey by the International Monetary Fund (IMF) which shows that in 2011 total outstanding loans from commercial banks was 29.64% of Indonesia's total GDP, while that of MSMEs in the same period was only 6.17%. In 2012 the ratio was 32.85% against 6.39% (Financial Services Survey, IMF 2012; http://fas.imf.org/). It is also consistent with the 2009 Enterprise Survey by the World Bank and International Finance Corporation (Kushnir, *et al*., 2010), suggesting a positive relationship between the size of firm and the percentage of firms having bank loans.

Next, Figure 1 presents the trend of development of MSMEs credit (mainly for working capital and investment) by commercial banks in Indonesia overtime, and Table 3 provides data on MSMEs credit by sector. Supply of credits to MSMEs does increase annually, though the level or the rate of credit growth received by the enterprises vary by sector. However, in terms of percentage of total credit (business (investment and working capital) and consumption) by commercial banks, the level is much less than 30% on average per year; much lower than the percentage of credit received by large LEs.

Figure 1. Total Credits Received by MSMEs and LEs from Commercial Banks in Indonesia, 2011-2014 **(% of total business and consumption credits)**



Note: 2013= December; 2014=March
Source: OJK (2014)

Table 3. Total MSMEs Bank Credits by Sectors, 2011-2014 (billion Rupiah)

	2011 Dec.	2012 Dec	2013 Dec	2014 March
Total sectors	458,164	526,397	608,823	619.400
Agriculture, Livestock, Forestry and	29,794	43,609	51,900	53.094
Fishery	3,938	5,427	4,753	5.047
Mining and Quarrying	52,231	59,500	60,087	64.187
Manufacturing Industry	1,218	1,474	1,750	1.664
Electricity, Gas and Water Supply	24,279	30,594	38,780	36.314
Construction	212,462	262,584	341,188	346.287
Trade, Hotel, and Restaurant	18,068	20,219	23,882	23.969
Transport and Communication	30,594	40,465	46,009	46.897
Financial, Ownership and Business	85,579	62,524	40,473	41.940
Services	1	0	1	-
Other services				
Not Identified				

Source: BI (www.bi.go.id)

In financing MSMEs, Indonesia in fact had some institutional development successes in the years up until the 1997/98 Asian financial crisis. These successes included the development of a comprehensive set of institutions serving all levels of the market. But, the financial institutions concerned were less efficient and comprehensive and they faced certain difficulties even before the crisis. Many of the financial institutions were financially and structurally weak, was manifest in high transactions costs and limits on their penetration of the market. As a result, the overwhelming number of MSEs was not served (Martowijoyo, 2007).

The loan portfolios of most of Indonesia's big banks are still dominated by loans to large businesses and corporate clients. As per 2012, total financing of MSMEs in Indonesia only 20.1% of total bank credits in the country. Regarding MIEs, only 20.7% of total MSMEs finance of Rp 612 trillions. According to Indonesian central bank (Bank Indonesia or BI), there are some reasons that only a small portion of total MSMEs in Indonesia ever financed by banks are many, and two most important ones are (i) their businesses are often considered by banks or other formal non-bank financial institutions not visible, either from the market perspective, i.e their made products are not highly demanded, and from their management perspective, i.e. their minimum capability to manage their businesses professionally (especially MSEs are not well organized activities or businesses without a well developed structure of organization and a good management system), and (ii) lack of valuable assets to be used as collaterals (Kompas, 2013).

Rosengard and Prasetyantoko (2012) also conclude that Indonesia is underbanked, meaning that people or businesses in the country have poor access to mainstream financial services normally offered by retail banks, especially for microfinance and MSME finance. From six largest banks, only the portfolios of Bank Rakyat Indonesia (BRI) and Bank Danamon include a majority share of

MSME loans. They state that despite potentially lucrative unserved or underserved markets, including low-income households and family businesses, the monetary policy and regulatory regime in Indonesia set by BI have unintentionally created barriers to outreach and innovation for microfinance institutions and incentivized commercial banks to forsake MSME finance in favor of consumer finance and alternative non-loan investments.

During the 1997/98 Asian financial crisis MSMEs were proved to be more resilience than their larger counterparts to the crisis, and because of them rapid increase in unemployment (caused by many bankrupted LEs which directly hit by the crisis) could be prevented. Since then, BI has been encouraging commercial banks to lend to MSMEs through self-determined targets in their business plans. BI has also defined micro-credit broadly to include loans up to Rp50 million (approximately US$5,450). Under this broad definition, commercial banks in Indonesia dominate microcredit, in which in 2007 served 48% of total borrowers with loans totaling 82.8% of the aggregate outstanding microfinance loan portfolio. BRI Units, which up to 2007 number nearly half of total commercial banks' outlets, accounted for 10.8% of borrowers and 12.6% of outstanding micro-loans. The average micro-loan size of commercial banks was US$ 983.50 or around 85% of income per capita, as compared to US$53 for BKD (*Badan Kredit Desa* or village credit institution), or approximately 5% of per capita income (Martowijoyo, 2007).

Indonesian MF

Indonesia is one of the developing countries that successfully run sustainable MF in a relatively large scale. It has a long experience with the implementation of MF started since early 1970s, with BRI as the key engine and the Indonesian government keeps improving systems of existing micro-credit schemes and strengthening their implementation process. BRI unit network is now the largest and one of the most profitable rural micro-banking networks in the developing world. Therefore, this makes MF in Indonesia an interesting research subject from which we hope to learn some best practices in this area. Indonesian government has been taking measures to improve MF, and for this aim, recently, the government has launched two new regulations/acts, namely UU No 17 2012 on cooperative (as cooperatives in Indonesia are also encouraged by the government to act as a MFI), and UU No. 1 2013 about MFI. MF/micro credit is defined by BI, as a loan below Rp. 50 million (US$5,373), a financial product provided by formal and semi-formal financial providers in Indonesia (Bramono, *et al*., 2013).

During the Suharto/'New Order' era (1966-1998) there were many popular MF programs, including *Bimbingan Massal* (Bimas), or mass guidance: a rice intensification program with a subsidized credit component for rice farmers, allocated through village unit credit or *Kredit Unit Desa* (KUD), and BRI Unit Desa (village-based BRI) (which succeeded later on by *Kredit Usaha Tani*, i.e. subsidized farming credit for small-sized farmers), and two special credit schemes for MSEs in agriculture, i.e. *Kredit Investasi Kecil* (KIK) or small investment credit, and *Kredit Modal Kerja Permanen* (KMKP) or permanent working capital credit, and various special credit schemes for MSEs in other sectors, e.g. *Kredit Mini, Kredit Midi*, and *Kupedes* and *Kredit Candak Kulak* (KCK) allocated through KUD. Yet many other MF were implemented during that period at local level such as *Kredit Usaha Rakyat Kecil* (KURK), or business credit for small people/the poor, in 1984 in East Java, and *Kredit Usaha Kecil* (KUK), or small business credit, i.e. loans to MSMEs and cooperatives to fulfill banks' credit quota of 20% of loan portfolio (Martowijoyo, 2007).

Besides those MF schemes, during the new order era a special village-based non-bank MFI institution was established, namely *Lembaga Dana Kredit Perdesaan* (LDKP), or rural credit fund institution, and yet many others such as *Badan Kredit Kecamatan* (BKK) in Central Java and South Kalimantan, which are sub-district level microfinance institutions founded by the Provincial Government of Central Java in the 1970s, *Lembaga Perkreditan Kecamatan* (LPK) in West Java, *Lumbung Pitih Nagari* (LPN) in West Sumatera, and *Lembaga Perkreditan Desa* (LPD) in Bali (Baskara, 2013).

Indonesia has also replicated Grameen Bank program. It was started in Bogor, West Java, by Karya Usaha Mandiri (KUM) in 1989. This initiative was followed in 1993 by Mitra Karya East Java (MKEJ) in Malang, East Java. In Sumatra, Grameen Bank model was replicated by Yayasan Pokmas Mandiri (YPM) (Sarumpaet, 2005)

As the largest Muslim country in the world, Islamic finance was also introduced during the New Order era as an option for the low-income people to get funds in order for them to uplift their well-being and to get themselves out of the poverty. But, only after the Asian financial crisis , Indonesia started to implement Islamic microfinance . There are three types of Islamic MF: (i) the Islamic Rural Bank, well known as *Bank Pembiayaan Rakyat Syariah* (BPRS); (ii) *Koperasi Baytul Maal wat Tamwil* (KBMT), which is a savings and credit cooperative implementing a profit and loss sharing approach; and (iii) Gramen model Islamic MF. These three institutions are contracted with micro Takaful (micro insurance in Islamic context) provider via an agent known as *Takaful Mikro Indonesia* (Timberg, 1999; Haryadi, 2010; Khadijah, *et al*., 2013).

BPRS, started in the early 1990s, is governed by BI under Law No. 10, 1998. It operates under the same effective prudential regulation and supervision as commercial banks and conventional rural banks (BPR), and it focuses on micro economic activities. While both BPR and BPRS are (mostly) established by wealthy local people, the owners of BPR are commercially oriented towards increasing their wealth, while the owners of BPRS have a social mission, combined with the intention to at least cover their costs. In a financing transaction (loan), BPRS provides financing to mainly MIEs either with a purchase system (*murabahah*), profit and loss sharing (*musyarakah*) or lease (*ijarah*). The choice of the Islamic system is dependent upon the type of financing proposed by the society to the BPRS. In addition, the BPRS also practices Islamic pawnshop (*ar-rahn*) run by the Islamic system (Haryadi, 2010; Khadijah, *et al*., 2013).

Other also very important MFIs are including (i) BKD (village credit institution), which has the longest history as it was among the first established MFI before the independence of the country, consisting of *Lumbung Desa* (paddy banks) and *Bank Desa* (village banks), which are MFIs originating in the Dutch colonial time and still operating in Java and Madura (and they have been awarded a BPR license); (ii) *Lembaga Dana Kredit Pedesaan* (LDKP), or rural credit institution, established in 1980s by then the Suharto government with the main aim to grouping all existing non-bank MFIs operating in all over the country, especially in Java since 1970s; (iii) BKK, LPK, LPN and LPD established in the 1970s and 1980s (Martowijoyo, 2007; Baskara, 2013).

A variety of old and new MFIs exist in Indonesia, including: (1) BRI Units; (2) BPRs consisting of BKDs (village credit institutions) and non-BKDs ("new" BPRs and old MFIs that have converted to BPR status); (3) non-bank non-cooperative MFIs (LDKPs, sub-district and village-level MFIs founded by provincial/district governments); (4) cooperatives (credit cooperatives and saving and loan units, including credit unions and BMTs); (5) Grameen Bank replicators (mostly unlicensed), and some NGOs, most of which have a foundation license (Martowijoyo, 2007).

Among those huge number of MFIs, currently, the key ones in Indonesia are (i) BRI, which is still considered as the leading MFI; (ii) Bank Syariah, (iii) BPR; (iv) BPD (*Bank Pembangunan Daerah*, or regional development bank) and (v) a number of commercial banks. BRI and BPR have the longest experience in MF, established in early 1970s in all then 27 provinces (BRI itself was established in 1896 from previously AVB (*Algemene Volkerediet Bank*). In addition, there are many non-bank organizations also providing MF such as cooperative and local community initiated NGOs.

However, according to some observers, total bank and non-bank MFI and MF services in Indonesia currently are too many with overlapping regulations, coverage, and responsibilities that make the monetary authority and government not easy to evaluate and control the development of MF in the country. Even according Baskara (2013) finds that, for instance, in Bali alone there are many formal MFIs that targeted MSEs, including LPD; *Koperasi Unit Desa* (KUD) or village-based cooperatives, i.e. multipurpose village cooperatives supported by the government; *Koperasi Serba Usaha* (KSU); *Koperasi Simpan Pinjam* (KSP) (like credit union) established by local community, BPR, BRI (BRI BRI), and Danamon *Simpan Pinjam* (DSP), i.e. savings and loan units of Bank Danamon (a private commercial bank). He also finds many locally operating MFIs which are not registered officially by the monetary authority, not only in Bali but also in other provinces , such as *Badan Usaha Kredit Pedesaan* (BUKP) in Yogyakarta, *Lembaga Pembiayaan Usaha Kecil* (LPUK) in South Kalimantan, *Lembaga Kredit Pedesaan* (LKP) in West Nusa Tenggara, and *Lembaga Kredit Kecamatan* in Aceh. But, many of these informal local-based MFIs stopped their operations because they did in an unhealthy non-professional way.

Asian Resource Center for MF (ARCM) indicates that almost 9,000 public rural financial institutions that are not licensed, and can be categorised as generic BPRs, which include village-owned BKDs of Java and Madura, and *Lembaga Dana dan Kredit Pedesaan* (LDKPs) or Rural Fund and Credit Institution, owned mostly by provincial governments (or in some cases by villages) (http://www.bwtp.org/arcm/indonesia/ I_Country_ Profile/Indonesia_country_profile.htm).

Within the informal sector, a traditional and most popular MFIs found throughout the country is the *arisan*, the Indonesian rotating savings and credit association (ROSCA). The number of arisan is estimated to be in the millions. Many people join more than one *arisan* for economic and social purposes, while others manage *arisan* as a side job. In rural areas, traders offer loans against standing crops through the *tebasan* and *ijon* systems. Even smaller loans called *mindring* are provided by retail traders of clothes or household utensils. Farmers also commonly get in-kind loans of rice and farm inputs from traders or shopkeepers at prices higher than cash prices. Commercial moneylenders are also still operating in rural areas and catering to the short-term needs of the poorest, although they are not flourishing as in the past. Some moneylenders are disguising their activities under the name of cooperatives (Martowijoyo, 2007).

Unfortunately, the exact number of MFIs at this moment, especially non-banks, in Indonesia is not really clear. According to a study by Martowijoyo (2007) based on various sources, as of mid-2005, there were over 54,000 outlets for MF, serving over 29 million borrowers (13% of the population) and more than 43 million depositors (19% of the population). While, an article written by Haryanti (2014), there are about 600,000 bank and non-bank MFIs (including local-based informal institutions in all provinces), but the exact number is still being ascertained by the Financial Service Authority (or known in Indonesia as *Otoritas Jasa Keuangan* or OJK). Some of those MFIs already had a formal legal entity such as a limited-liability company status (PT) or a cooperative, and also had legal operating license as non-bank financial institutions. Nonetheless, they were still regarded as semi-formal entities. Some of those MFIs have proven to be effective in providing MF services to the so-called excluded or un-banked segment, such as peasants, MSEs, women and other economically active poor who mostly work in the informal sector, do not have assets that are valuable enough to act as collateral or probably have valuable assets but do not have legal documents protecting their assets. Those MFIs have offered many innovative approaches (including nourishing social capital and local wisdom to make social sanctions work effectively in replacing the function of physical collateral).

Annual aggregate data on micro credit are also limited. BI does have data on total distributed credits/loans (monthly, quarterly and annually) by group of banks, sector, type of credit, and region. But no specific data on micro credit; data on total distributed credits are also including micro credit. ARCM which has Indonesian profile with respect to MFI development in its website does not have data on total micro credits provided by all banks and formal non-bank financial institutions (http://www.bwtp.org/arcm/ indonesia/ I_Country_ Profile/ Indonesia_country_profile.htm).

Even, Siregar (2014) in his presentation about MFIs in Indonesia only provides aggregate data for 2005 (Table 4). According to his data MFIs in Indonesia are dominated by informal MFIs which consist of 637,838 LDKP, BKD, and various MF units initiated by local community such as credit union, BMT, NGOs. While based on data collected from various sources by Martowijoyo (2007) combined with data from OJK (2014), a summary table of breakdown of MF by key institutions (Table 5).

Table 4 Total MFIs in Indonesia, 2005

Institutions	Total units	Total Depositors and Debtors (Person)
BRI Unit Desa	4,046	30,776,000
BPR	2,161	5,480,000

Non-bank finance institutions	7,617	2,084,000
Cooperatives	6,495	6,100,000
Arisan Others	250,000 105,147	5,000,000 22,855,000
Total	375,466	72,295,000

Source: Siregar (2014).

Table 5 MF by Key Institutions in Indonesia

Institution	No Units/ offices	Borrowers (000)	Outstanding loans (US$ million/Rp billions)	Depositors (000)	Deposits (US$ million/Rp billions)
Commercial banks' micro loans (2006) (March 2014) -BRI Units (2002) (2005) (2007) (March 2014)	 8,069 18,704 3,916 4,046 5,400 9,350	 14,271 na 3,000 3,211 na 9,794.8	 US$14,036 na Rp 12,000 US$2,134 na Rp27,721.1	 na na 28,200 31,271 na na	 na Rp 1,652,976 Rp 23,460 US$3,288 na na
Rural banks (BPR): (2003) (2005) (March 2014) - BKD (2002) (2005)	 2,133 4,482 4,717 5,345 2,062	 1,900 395 na 450 2,331	 Rp 7,088 US$21 Rp 58.977 Rp 185 US$1,380	 5,100 466 na 540 5,864	 Rp 6,629 US$51 Rp34.963 Rp 25,000 US$1,223
LDKP (2005)	1,620	1,326	US$45	na	US$42
Credit cooperative (2004) -Credit Unions (2004)	1,596 1,041	885 na	US116 US958	481 480	US$33 US$0.94
S&L Units (2004) -BMT (2004)	36,466 3,038	10,524 1,200	US$1,349 US$20	5,016 na	US$145 US$26
Grameen Bank Replicators (2007)	21	20	US$0.52	20	US$0.30

Sources: Martowijoyo (2007) and OJK (2014).

Alternatively, information on micro credit should be collected from individual MF providing banks (e.g. BRI, BPR, etc) and other non-bank organizations. One organization which is doing this way is Mixmarket Organisation. It has a unique database sourced from more than 15,000 MFI data submissions over the past 10 years covering more than 2,100 MFIs in over 110 countries, including Indonesia. Some data from selected MFIs in Indonesia are presented in Table 6 (for more data: http://www.mixmarket.org/microfinance-data#ixzz 34PL8lam6).

Table 6: Profiles of Selected MFIs in Indonesia in 2011 Onwards

MFI	Report Year	Loans (US$)	Number of borrowers	Deposits (US$)	Number of Depositors
Amartha Microfinance	2013	205,890	2,612	26,143	2,617
Bina Artha	2012	2,041,313	21,397	na	na
Bina Artha	2012	2,041,313	21,397	na	na
BMT Sanama	2012	452,733	188	55,748	342
BPR AK	2011	5,739,431	7,841	3,156,576	30,852
BPR DMG	2011	920,710	525	904,781	1,910
BPR Hitamajaya	2011	2,117,364	2,344	1,111,037	7,565
BPR NBP 2	2011	5,119,451	6,302	2,525,500	20,817
BPR NSI	2011	4,587,175	14,523	1,052,444	9,242
BPR Pinang Artha	2012	5,470,846	3,683	5,813,842	33,241
BPR Surya Yudha Kencana	2011	70,274,699	35,530	50,295,139	74,679
BRI	2012	10,897,400,395	na	12,918,433,257	na
CU Sawiran	2012	5,470,846	3,683	5,813,842	33,241
Dian Mandiri	2013	2,709,156	44,276	819,459	na
KOMIDA	2011	5,583,754	68,278	530,937	45,518
Koperasi SK	2012	5,470,846	3,683	5,813,842	33,241
MBK Ventura	2014-	54,721,534	369,738	na	na
Mitra Usaha	2010	489,684	5,277	389,627	4,664
TLM	2013	12,597,849	32,407	13,836,030	na
WKP	2011	87,086	684	17,579	na
MBK Ventura	2014	54,721,534	369,738	na	na

Source: mixmarket organization (http://www.mixmarket.org/mfi/country/Indonesia#ixzz34PJrzGCz).

Probably the most important or the most famous MF scheme in Indonesia after the Suharto era is *Kredit Usaha Rakyat* (KUR), or people/community business credit, launched by President Susilo Bambang Yudhoyono (SBY) in November 2007. The main aim of KUR is to help financing feasible but not bankable MSEs, which is known as credit without collateral. It is loan for working capital and investment capital for individual producers/owners of productive MSEs and cooperatives with credit upper limit up to Rp 500 million. The scheme is 100% financed by national commercial banks, i.e. BRI, Bank Negara Indonesia (BNI), Bank Mandiri, Bank Tabungan Negara (BTN), Bank Syariah Mandiri (BSM), Bank Bukopin, and Bank Negara Indonesia Syariah (Table 7) and since 2012 all BPD in all provinces in Indonesia are also playing an important role in allocating KUR. While, non-bank financial institutions are not involved in this program.

Table 7 Realized KUR by National Banks (31 March 2014)

NO	BANK	Realized KUR			
		Plafond	Outstanding	Total Debtors	Average per debtor
		(Rp million)	(Rp million)		(Rp million)
1	BNI	14,336,912	3,904,556	205,550	69.7
2	BRI (Ritel KUR)	18,045,443	7,077,418	103,993	173.5
3	BRI (Micro KUR)	75,789,311	20,643,642	9,690,827	7.8
4	BANK MANDIRI	14,945,991	6,525,545	315,432	47.4
5	BTN	4,368,962	1,918,574	24,238	180.3
6	BUKOPIN	1,795,455	605,849	12,011	149.5
7	BANK SYARIAH MANDIRI	3,658,132	1,387,260	52,019	70.3
8	BNI SYARIAH	245,784	109,897	1,256	195.7
	TOTAL	**133,185,989**	**42,172,743**	**10,405,326**	**12.8**

Source: *Komite Kredit Usaha Rakyat,* Ministry for Economic Coordination (http://komite-kur.com/article-95-sebaran-penyaluran-kredit-usaha-rakyat-periode-november-2007-maret-2014.asp)

KUR received by MSEs is guaranted (70 percent) by two insurance companies, i.e. *PT. Asuransi Kredit Indonesia* (PT. Askrindo) and *Perusahaan Umum Jaminan Kredit Indonesia* (Perum Jamkrindo) and other companies which are voluntary joined the program. PT Askindro provides two types of services: (1) credit guarantee: bank and non-bank credit guarantee, counter bank guarantee, and regional credit guarantee; and (2) credit insurance: trade credit insurance, surety bond, customs bond, and reinsurance. PT JAMKRINDO with the main aim to provide credit guarantee services to MSEs including government program and commercial credit, has various MSEs credit guarantee products: micro credit guarantee, guarantee for construction, goods and services procurement loans, commercial credit guarantee, counter bank guarantee, multipurpose credit guarantee, guarantee for distribution, Islamic financial guarantee (*Kafalah*), loan program credit guarantee (KUR). PT JAMKRINDO has various products: micro and small credit guarantee, multipurpose credit guarantee, credit guarantee for construction, and goods and services procurement, contra bank guarantee.

Among the eight national banks providing KUR, BRI is the leading one, which has three main objectives: (i) increasing financing access of MSEs and cooperatives to banks; (ii) lessons learned for MSEs in becoming a bankable debtor which can therefore be served in accordance with banking commercial terms in general (as an embryo of commercial debtor); and (iii) it is expected that the financed business can grow and develop continuously. BRI has two types of KUR: (i) micro KUR for an individual running a feasible productive business (MIEs) with length of business of 6 months at the minimum, and (ii) retail KUR for an individual (individual person/legal entity) or cooperative running a feasible productive business with length of business of 6 months at the minimum. For micro KUR, credit upper limit of Rp 20 million at the maximum with effective interest rate of 22% per year, and for retail KUR, credit upper limit of Rp 100 at the maximum with effective interest rate of with the interest rate 14% per year. Credit types are working capital credit with maximum 3 years (in case of renewal, suppletion, restructuring: maximum 6 years) and investment credit with maximum 5 years (in case of renewal, suppletion, restructuring: maximum 10 years).

With respect to allocation of KUR by productive sector (as the main target of this scheme), trade (which is integrated with upward sectors) revealed as the dominant sector in getting KUR with the proportion of 50.79%. Whereas, agriculture and fishery received 13.7%, and industry manufacturing 2.6%. By accumulating the amount, the allocation of KUR to upward sectors covering agriculture, maritime, fishery, forestry, and industry have the share of 31.4% from total KUR allocated to all sectors (Muis and Sipayung, 2013).

Tabel 8. Realised KUR by Sector of Economy (31 Maret 2014)

NO	Sector	TOTAL		
		Plafond (Rp million)	Outstanding (Rp million)	Total Debtors
1	Agriculture	25,220,484	9,959,299	1,659,144
2	Fishery	837,614	213,788	11,695
3	Mining	117,323	50,191	3,729
4	Manufacturing industry	4,066,523	1,673,872	216,945
5	Electricity, gas and clean water	74,599	32,094	2,400
6	Construction	2,066,813	580,478	11,390
7	Trade	82,368,475	27,716,357	6,972,338
8	Accommodation supplying	1,050,399	328,918	41,337
9	Transportation	2,018,075	957,995	51,466
10	Financing services	1,032,825	300,719	7,008
11	Rental	6,768,982	2,869,136	350,437
12	Government administration	33,741	22,648	1,694
13	Education service	87,212	28,436	716
14	Health care service	383,267	103,885	3,120
15	Community services	4,277,720	1,128,842	113,235
16	Individual services	145,269	53,835	1,232
17	Other	16,662,958	1,971,239	1,134,644
Total		**147,212,280**	**47,991,733**	**10,582,530**

Source: *Komite Kredit Usaha Rakyat,* Ministry for Economic Coordination (http://komite-kur.com/article-95-sebaran-penyaluran-kredit-usaha-rakyat-periode-november-2007-maret-2014.asp)

Many people assessed KUR as a successful MF program for MSEs. Even, President SBY was highly appreciated by International Micro Finance Community for his successful in implementing KUR in particular and microfinance in Indonesia in general by awarding him 'Letter of Recognition' in October 2012. The success of KUR is indeed not unrelated with the well internationally recognized successful of Indonesia, BRI particularly, in implementing microfinance. Therefore, Indonesia has been mentioned as the potential world laboratory for microfinance.

Key Challenges

Although Indonesia has a long experience with the implementation of MF started since early 1970s, and the country is considered as one among only few developing countries that successfully run sustainable microfinance in a relatively large scale, still many challenges the country has to face. According to an evaluation made by ARCM (http://www.bwtp. org/arcm/ indonesia/I_ Country_Profile/Indonesia_country_ profile.htm), the key challenges are the followings. First, several studies have demonstrated that there is still an unmet demand for MF in Indonesia, as a majority of rural households still do not have access to a source of funds from a semi-formal or formal institution. The key MF providers, i.e. BRI Units and BPRs, tends to cover mostly the upper levels of MSMEs in district capitals, sub-district towns and economically active regions (e.g. Java and Bali) with loans of more than Rp.3 million (US$320), while NGOs, cooperatives, and BKDs reach a lower end of the market (rural MIEs) but still have a limited outreach in rural areas. BRI Units expansion seems constrained by the 'cash cow' status it has within the bank. BPRs mostly operate in affluent, urban areas of Java and Bali. Their expansion is limited by the high capital requirements to open new branches or operate outside a specific district. Second, the supply-led subsidized microcredit programs initiated by the government do not provide an conducive environment where sustainable MF providers can operate. Third, there is a lack of awareness and application of basic MF principles among government agencies, semi-formal organizations and some commercial banks that have entered the MF recently. There is still no central MF training provider in Indonesia. Fourth, technical assistance and capacity building support to MF providers have been limited by the diversity and geographical spread, and only few organizations have benefited from non-financial support; although BI has recently tried to address this problem. Fifth, there is no formal credit bureau in Indonesia, which could be used to prevent risks of over-indebtedness in areas of strong competition (cities and main districts towns). Banks involved in MF, such as BRI Units and BPRs exchange information on their clients on an informal basis.

Conclusion and Policy Recommendation

As already explained in the beginning, this study has one limitation: it could not come with strong empirical evidence on the role of MF/MFIs in financing MSMEs due to lack of data on total micro credits allocated to these enterprises. Nevertheless, this study has at least two (2) reasons to conclude that MF in Indonesia is important for MSMEs, namely (i) total commercial credits (which may also included micro credits) received by MSMEs increased every year, and the absorption rate of KUD by MSEs is not only high but also tends to grow every year.

After the Asian financial crisis, Indonesia has adopted financial inclusion strategy as part of its 'inclusive national development policy' with the objective to increase economic growth and welfare of the population. This new strategy includes strategies to improve the effectiveness, efficiency, sustainability and health development of MF services in Indonesia. Indeed, despite the fact that Indonesia has a long experience with MF, and within

ASEAN, it is the most successful country in implementing MF programs or in the development of MFIs, the country still need to deal with various problems. First, there is lack of awareness of sound principles of MF within the implementing organizations in Indonesia. One way to solve this problem, there should be centralized training centers in all parts of the country where the different players in MF can go and get additional training and support. Second, most of the MF programs/schemes that have been relatively successful have been located in Java and Sumatra, and the bulk of the MFIs and programs in Indonesia are located in the urban area. So, the coverage should be expanded into other parts of the country, and more attention and energy should be given to develop effective MF programs in regions outside Java and Sumatera, especially rural community or those living in rather less developed/isolated regions and in border regions like in Papua and Kalimantan. To achieve this, two actions should be taken by the government: (i) to establish credit information (including information on exiting MF programs and MFIs) and bureau with offices in all cities and main districts towns in all provinces, which could be used by community to find MFIs that can provide MF services they need and also to prevent risks of over-indebtedness in areas of strong competition among MFIs. Third, there are many (or even too many) MFIs (including in the informal sector) with overlapping target, coverage and regulations beyond the control of the monetary authority. Therefore, the monetary authority or government should have a fully control of the growing number of especially non-bank and informal MFIs and their ways of operations. The monetary authority should reorganize all MFIs still operating not only at national level but also at regional level. Fourth, many MFIs, especially non-bank institutions are operating inefficiently and too dependent on continued government financial supports. Therefore, in order to have sustainable successful MF programs or activities in Indonesia, all implementing MFIs need to improve their management and operation capacity in order to operate efficiently and independently. Fourth, unfriendly business environment, caused by among other factors lacks of security and certainty, is still problem in the country. So, the government should provide an conducive environment that should be backed by law enforcement for MFIs to be able to operate smoothly and efficiently.

In overall, however, the successful of MF programs or development of MFIs in Indonesia will strongly depend on two key factors: supply-side factors and demand-side factors. The supply-side factors are a group of factors affecting the efficiency and capacity of MFIs, whereas, the demand-side factors are a group of factors affecting the demand for MF services including the capacity of micro borrowers to payback their credit on time (or zero non-performing loan).

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